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SUBJECT: UKRAINE: POLITICAL LEADERSHIP MAKES RENEWED EFFORT
TO PUT IMF LOAN BACK ON TRACK

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Summary

¶1. (SBU) On March 11 President Yushchenko, PM Tymoshenko and NBU Governor Stelmakh met and announced concrete steps aimed at securing the overdue $1.8 billion second tranche of the IMF loan program. Most importantly, they pledged to reduce the planned budget deficit to 3 percent of GDP, a level acceptable to the IMF providing Ukraine is able to fund it without borrowing from the NBU. The GOU also took swift action to reverse provisions of the budget law that, in the IMF's view, curtailed the independence of the NBU. The IMF told us that it would await concrete action on the promised measures before sending a team to Kyiv that would ultimately recommend paying out the second tranche. The World Bank pointed out that the announced measures will not be sufficient to reduce the deficit to planned 3 percent, and that other, politically difficult cost cutting measures will be necessary. The GOU also said it approved a balanced 2009 financial plan for Nafthohaz that, under closer scrutiny, appears to reduce costs this year at the expense of future transit fees. By all accounts, Ukraine's economic situation is decaying quickly, and if the GOU succeeds in following up on the promises then Ukrainian requests for direct budget support will need to be addressed swiftly. End summary.

President, GOU, NBU Promise Swift Action

¶2. (SBU) On March 11 Yushchenko, Tymoshenko and Stelmakh said Ukraine would take all steps necessary to secure the next tranche in the IMF's $16.4 billion Stand-By Agreement (SBA). The tranche of $1.8 billion should have been dispersed in mid-February, but has been delayed over Ukrainian failure to fulfill key IMF conditionalities.

¶3. (SBU) Alexander Shlapak, first deputy head of the Presidential Secretariat, and acting Finance Minister Igor Umanskiy both told the media separately that the GOU would reduce the planned budget deficit from expected 5 percent to 3 percent of GDP through a mixture of reduced expenditures and increased revenues. The Rada would vote this week on pension reform and excise tax bills, both of which, if passed, would help reduce the deficit, Umanskiy said. The announced intention to sharply curtail the projected deficit to three percent of GDP marked a change over previous pronouncements by the GOU, including PM Tymoshenko's statement to the G7 last week (reftel), in which she claimed

that a further reduction of the budget deficit was not possible.

IMF, World Bank Want to See Action

¶4. (SBU) Both the IMF and World Bank told us on March 12 that the announced intention to reduce the budget was a positive development, but cautioned that the GOU would still need to deliver on its promises. Local IMF spokesmen have been careful not to indicate when the IMF Mission might return. Kyiv-based IMF advisor Igor Shpak told us IMF would require the GOU to take a series of steps, either through legislative action or executive resolutions, before it would contemplate a return of the IMF Mission. He emphasized that statements by Yushchenko and GOU spokesmen envisaging a return of the IMF by as early as this week were unfounded.

¶5. (SBU) Acting World Bank country director Pablo Saavedra told us on March 12 that the planned measures on pensions and the excise tax were "watered down" versions of earlier World Bank suggestions to reduce the planned deficit. Taken together, they would reduce the planned deficit by about 0.8 percent. The GOU also planned to introduce 2 percent surcharges on gasoline and residential natural gas taxes, both of which would reduce the deficit by another 0.15 percent. Hence the GOU still needed to come up with savings equal to about one percent of GDP to meet the IMF goal of a deficit equal to 3 percent of GDP, Saavedra said.

CabMin Proactively Rescinds NBU Restrictions

¶6. (SBU) On March 11 the Cabinet of Ministers also approved a draft law that would eliminate paragraphs 84 and 86 of the

budget law. These provisions had, in the IMF's view, severely reduced the NBU's independence. The disputed paragraphs compelled the NBU to purchase government debt, and required that the central bank coordinate its refinancing of banks directly with the CabMin. The draft will now go before the Rada for a vote. In addition, the CabMin rescinded an earlier decision that gave First Deputy PM Turchinov the mandate to oversee the NBU's refinancing actions. Hence the GOU is not waiting for the Rada to take action on the amendments before formally withdrawing from its intervention into the NBU's refinancing policy. In a statement to the media, however, Deputy PM Nemyrya said that the GOU would continue to ensure that the NBU "acted responsibly" in its refinancing policy. In December, the NBU had come under strong criticism after internal reports, leaked to the media, appeared to indicate that the central bank had engaged in favoritism when providing banks with badly needed short-term liquidity.

NaftoHaz Financial Plan Balanced, With Tricks

¶7. (SBU) The GOU also announced that it approved a 2009 financial plan for Naftohaz that actually foresees revenues exceeding costs. The GOU claimed that it will introduce cost-cutting measures at Naftohaz, yet according to media reports the bulk of the savings will come from financial and accounting measures that do little to improve the true financial situation at the permanently cash-strapped energy monopoly. The GOU said it would forego UAH 5.5 billion ($725 million) VAT due from Naftohaz for gas imported in 2008. In addition, the planned purchase of 15 billion cubic meters of gas from Gazprom for pumping into storage during the summer months is not included in the financial plan. Umanskiy said the GOU hoped to secure the $3.42 billion needed to purchase the gas by borrowing from either the World Bank or Gazprom. "Not from us," the World Bank's Saavedra told us when asked about Umanskiy's statement. IMF's Shpak told us that the GOU's idea of a "Gazprom loan" was in reality a suggestion

that Naftohaz would offset Russian gas deliveries this summer against future transit fees paid by Gazprom. In effect Naftohaz was suggesting paying for gas today at the expense of future revenues, Sphak said. In the Russian media Gazprom spokesmen had denied that the company was discussing a loan with Naftohaz.

Comment

¶8. (SBU) This latest meeting between Yushchenko, Tymoshenko and Stelmakh, who appears to be firmly in the saddle at the NBU once again (septel), yielded the most concrete promises to date aimed at getting the IMF plan back on track. The GOU and Rada now need to act, however, at it remains to be seen whether their actions will be sufficient to secure a timely return of the IMF Mission. As the World Bank's budget calculations show, the GOU will have to take further painful and politically difficult decisions to remove the planned deficit to levels acceptable to the IMF. If the GOU succeeds in getting the IMF program back on track, then Ukraine's leadership will have demonstrated that it is serious about addressing the crisis, and requests for direct budgetary assistance will need to be taken seriously and addressed quickly. End comment.
TAYLOR